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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1953.

No. 779

MISSION CORPORATION,

*Petitioner,*

*vs.*

ISADORE BLAU, a stockholder of TIDE WATER ASSOCIATED OIL COMPANY, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of TIDE WATER ASSOCIATED OIL COMPANY,

*and*

TIDE WATER ASSOCIATED OIL COMPANY,

*Respondents.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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May 20, 1954.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1953.

No.

MISSION CORPORATION,
Petitioner,

*vs.*

ISADORE BLAU, a stockholder of TIDE WATER ASSOCIATED OIL COMPANY, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of TIDE WATER ASSOCIATED OIL COMPANY,

*and*

TIDE WATER ASSOCIATED OIL COMPANY,
Respondents.

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

*To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:*

Your petitioner, Mission Corporation, respectfully prays that a writ of certiorari be issued out of and under the seal of this Court to review the decision of the United States Court of Appeals for the Second Circuit rendered on February 24, 1954 (R. 49)[1] and modified by the deci-

[1] Record references are in parentheses and refer to the numbers appearing at the top of record pages. References to pages of Appendix to Brief for Plaintiff-Appellant below are in italics, e.g. (*R. 1a*). References to pages of Appendix to Brief for Defendant-Appellee below are in plain type, e.g. (R. 1a), as are references to proceedings had in the Court of Appeals for the Second Circuit, e.g. (R. 49).

sion rendered on the granting of petition for rehearing on April 19, 1954 (R. 76), which reversed so much of a judgment of the United States District Court for the Southern District of New York made and entered June 22, 1953 as dismissed the second cause of action alleged in the complaint. Said decision affirmed so much of said judgment as dismissed the first cause of action. A certified transcript of the record is furnished herewith in accordance with Rule 38, Par. 1, of the Rules of this Court.

## Jurisdiction.

Jurisdiction in this case upon writ of certiorari is conferred on this Court by 28 U. S. C. §1254(1) (c. 646, 62 Stat. 928).

The original opinion of the Court of Appeals for the Second Circuit was filed February 24, 1954 (R. 49). Petition for rehearing was granted on April 19, 1954 (R. 76), and the mandate and order and judgment of the Court of Appeals for the Second Circuit issued forthwith on February 19, 1954 (R. 77, 78). Execution of the order and judgment made and entered on April 26, 1954 by the United States District Court for the Southern District of New York on the mandate was stayed by order of said United States District Court on April 29, 1954, until May 25, 1954, conditioned upon the filing of this petition for certiorari, on or before May 25, 1954, and the giving of security in the amount of $30,000 on or before May 3, 1954, which conditions have been fulfilled.

## Opinions Below.

The opinion of the district court is reported in 113 F. Supp. 153 and is also printed in the record (*R. 15a-21a*).

The original opinion of the Court of Appeals has not yet been officially reported and is printed in the record (R. 49-54). The opinion of the Court of Appeals granting the petition for rehearing is also printed in the record (R. 76-77).

## Statute Involved.

The pertinent provisions of the Securities Exchange Act of 1934 (c. 404, §16(a)(b), 48 Stat. 896, 15 U. S. C. §78 p (a)(b)) are as follows: (The complete text of said sections is set forth in Appendix A, p. 25.)

> "Sec. 16(a). Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, • • • shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner • • • a statement with the exchange • • • of the amount of all equity securities of such issuer of which he is the beneficial owner.
>
> "Sec. 16(b). *For the purpose of preventing the unfair use of information* which may have been obtained by such beneficial owner • • • by reason of his relationship to the issuer, *any profit realized* by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months • • • *shall inure to and be recoverable by the issuer,* irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. • • • This subsection shall not be construed to cover any transaction where such beneficial owner was not such both

at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." (Emphasis supplied.) (c. 404, §16(a)(b), 48 Stat. 896, 15 U. S. C. Sec. 78 p (a)(b).)

## Questions Presented.

An important question of statutory construction is presented concerning what constitutes a "sale" of securities by an "insider" in connection with intercorporate transactions. The Court of Appeals in this case stated it was proceeding on "uncharted seas" and in a subsequent case that the "dividing line is somewhat shadowy". In reaching diametrically opposite conclusions with respect to two situations where there was a theoretical distinction found by the Court, although there was no real difference, the Court of Appeals served further to confuse the law.

(1) Was there a "sale" within the statutory requirement where the parent corporation retained the exact beneficial interest it held prior to the transaction in the same shares it allegedly "sold" to its subsidiary and received nothing else of value?

(2) Should the statute be interpreted to find as a "sale" within its meaning, an exchange in an intercorporate transaction where the beneficial interest was retained and where the express statutory purpose to prevent insiders profits in "short-swing transactions" was not and could not have been violated?

(3) Is the statutory requirement that "profits be realized" fulfilled on the facts involved?

## Statement of Facts.

Two transactions are involved. Both concern the exchange by Mission Corporation (hereinafter referred to as "Mission") of shares of the common stock of Tide Water Associated Oil Company (hereinafter referred to as "Tide Water"), for shares of the capital stock of its subsidiary, Mission Development Company (hereinafter referred to as "Development"), which after each transaction held no assets (except for an insignificant amount of cash) other than Tide Water shares.

Both transactions involved legitimate intercorporate dealings between parent and subsidiary, with no third parties involved, for a manifestly internal purpose which had nothing to do with and did not involve the disposition of the beneficial interest in the Tide Water stock or the realization of profit.

The first transaction: On December 4, 1948, Mission owned 1,416,693 shares of the common stock of Tide Water. Mission stated at the time that it was prompted by a desire (1) to keep this block of stock intact; (2) to preserve its cash position; (3) to enhance its position in Tide Water by using its cash reserves to acquire additional Tide Water shares and (4) to distribute taxable dividends to its stockholders to avoid the impact of Section 102 of the Internal Revenue Code (26 U. S. C. §102) (*R. 4a-5a;* R. 2a-3a, 29a, 34a, 35a).

Mission, therefore, organized Development on November 28, 1948, and agreed on December 4, 1948, with Development to exchange, in a tax free corporate reorganization, the shares of Tide Water then held for shares of the common stock of Development, to be issued on the basis of two shares of Development for each share of Tide

Water (*R. 4a;* R. 2a). After approval of the transaction by the Securities and Exchange Commission upon application made pursuant to Section 17 (a)(1) of the Investment Company Act of 1940 (54 Stat. 815, 15 U. S. C. §80a-17(a)(1)), the shares were exchanged, in the tax free reorganization, on December 17, 1948 (*R. 4a-5a;* R. 11a-14a). Thereafter, Mission continued to purchase shares of Tide Water in furtherance of acquisition of control (*R. 8a, 9a*). From time to time thereafter, Mission distributed shares of Development received on the exchange to its stockholders as a taxable dividend in kind (*R. 5a, 7a*). The first dividend was distributed December 28, 1948, and thereafter the shares of Development were actively traded in the open market (*R. 5a*).

By the first cause of action, recovery was sought of the profits alleged to have been realized by the "sale" claimed to have occurred on the exchange, and the subsequent purchase of further shares of Tide Water at prices below the market price of Tide Water on the date of the exchange.

The second transaction: On January 17, 1951, Mission, having acquired, after the first exchange, 1,050,420 additional shares of Tide Water common stock, exchanged such shares for 2,100,840 shares of the common stock of Development in a second tax free corporate reorganization, and pursuant to a Plan of Reorganization duly adopted (*R. 8a*). Prior approval of the Securities and Exchange Commission for this exchange was obtained pursuant to Section 17(a)(1) of the Investment Company Act of 1940 (54 Stat. 815, 15 U. S. C. §80a-17(a)(1)) (*R. 8a-9a*). Two shares of Development were received for each share of Tide Water, as in the first transaction (*R. 8a*). The assets of Development at the time of this exchange consisted solely of shares of Tide

Water received from Mission, plus a relatively insignificant amount of cash in excess of liabilities (*R. 8a-9a;* R. 50). The asset value of the Development shares was not changed. Each share of Development still represented one-half share of Tide Water held by Development, as it did prior to the exchange (*R. 8a-9a*).

By the second cause of action, recovery was sought of the profit claimed to have been realized from the purchase of shares of Tide Water, during the six months period preceding January 17, 1951, at prices below the market price of Tide Water on that date, and the "sale" on that date of such Tide Water shares by the exchange thereof for shares of Development.

On June 9, 1953, motion for summary judgment upon stipulated facts was made by plaintiff, and a cross-motion for summary judgment was made by Mission. The United States District Court, by decision filed June 19, 1953, granted the cross-motion for summary judgment dismissing the first and second causes of action, holding that, on both the first and second exchanges, no "sale", within the meaning of that term as used in Section 16(b) of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U. S. C. §78 p (b)), had occurred, because Development was merely the *alter ego* of Mission, and assets were merely moved from one corporate pocket to another, and that the mischief at which the statute is aimed could not exist, because inside information could in no way result in Mission's realizing profits in these transactions (*R. 15a-21a, 22a-23a*).

## Analysis of the Opinion of the United States Court of Appeals for the Second Circuit.

The Court of Appeals for the Second Circuit affirmed so much of the judgment of the District Court as dismissed the first cause of action, holding that the first exchange of

Tide Water shares for Development shares was not a "sale" within the meaning of Section 16(b) of the Securities Exchange Act of 1934, because Development was then wholly-owned by Mission, and the transaction was a mere transfer between corporate pockets (R. 51).

The Court of Appeals, however, reversed that portion of the judgment which dismissed the second cause of action, and remanded the action to the District Court for calculation of "profits", holding that the second exchange constituted a sale, even though Mission did not alter its beneficial interest in Tide Water or relinquish its actual control of the Tide Water block of stock, because at the time of the second exchange, shares of Development were in the hands of the public, and there was a market for the shares of Development received on the exchange. On the computation of damages, it was originally determined that the consideration received, namely, the Development stock, should be valued at the closing price of $15.50 on the date of the exchange, and the price of two shares of Development, or $31 per share, should be compared with purchases of Tide Water during the six months period for calculations of "profits" (R. 51-54).

A petition for rehearing was granted, the original opinion modified, and the action remanded to the District Court for hearing and findings anew as to the market value of the block of Development stock, with allowances for expenses actually incurred, in the calculation of "profits." It was also provided that any award, if made, bear interest from the time of sale (R. 76).

## Reasons for Granting the Writ.

1. In interpreting a federal statute, the Court of Appeals for the Second Circuit has decided an important question of federal law which has not been, but should be, settled by this Court. The Court of Appeals held that a "sale", under Section 16(b) of the Securities Exchange Act of 1934 (48 Stat. 896; 15 U. S. C. §16(b)), occurred on the second exchange of securities here, even though the beneficial interest was retained by the "seller", who retained, as well, actual control of the shares said to have been sold, and that profits are recoverable because "realizable value" was received (although not in fact realized). These questions of law and interpretation of a federal statute are important in that, as a result thereof, the statute, as construed by the Court of Appeals, is no longer a guide to conduct but departs from its plain meaning and intent. Moreover, defendant will be compelled to pay substantial damages representing "profits" it never received.

In deciding these important questions of law, the Court of Appeals conceded, in its opinion, that it was venturing upon uncharted seas without the guidance, as *amicus curiae*, of the Securities and Exchange Commission which, from time to time, has aided in the interpretation of other aspects of this Statute. The guidance of this Court is needed to restore to the statute its clear meaning.

2. The Court of Appeals for the Second Circuit has here rendered a decision which is believed to involve, not only an inconsistency in the interpretation and application of the statute as to the two causes of action set forth, but also a conflict with the principles announced in other cases decided in that circuit. The first exchange of Tide Water shares for Development shares was held not to be a "sale"

because this was a mere transfer between corporate pockets. The second transaction was said to be a "sale" of Tide Water shares, solely because a defined market for Development shares was said then to exist, although it was likewise an intercorporate reorganization between parent and subsidiary involving no third persons, and although beneficial ownership and control was retained and no profits realized.

The decision appears to be in conflict in principle with the decisions of the Court of Appeals for the Second Circuit in *Shaw* v. *Dreyfus*, C. A. 2 Cir. 172 F. 2d 140, certiorari denied, 337 U. S. 907, and *Roberts* v. *Eaton, et al.*, C. A. 2d Cir. April 5, 1954 (not yet officially reported, reprinted in Appendix B, p. 26).

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Court of Appeals for the Second Circuit, sitting at New York City, New York, commanding said Court to certify and send up to this Court, on a date to be designated, a full and complete transcript of the record and of all proceedings in the Court of Appeals for the Second Circuit had in this case, to the end that this case may be reviewed and determined by this Court; that the orders and judgments of the Court of Appeals for the Second Circuit be reversed; and that your petitioner be granted such other and further relief as may seem proper.

MISSION CORPORATION,

By BARNABAS B. HADFIELD,
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New York 4, N. Y.

May 20, 1954.

## BRIEF IN SUPPORT OF PETITION.

### Opinions Below.

The opinion of the District Court (*R. 15a-21a*) has been reported at 113 F. Supp. 153. The original opinion of the Court of Appeals for the Second Circuit is printed in the record (R. 49-54) and is not yet officially reported. The per curiam opinion of the Court of Appeals rendered on the granting of the petition for rehearing is printed in the Record (R. 76-77) and is not yet officially reported.

## ARGUMENT.

**I. An important question of statutory construction is involved requiring clarification by this Court.**

(a) The decision below is inconsistent within itself in holding differently with respect to each transaction, the facts concerning which present no real difference.

(b) The principles enunciated by the Court appear to be in conflict in principle with *Shaw* v. *Dreyfus*, C. A. 2 Cir. 172 F. 2d 140, cert. denied 337 U. S. 907, and *Roberts* v. *Eaton, et al.*, C. A. 2 Cir. decided April 5, 1954 (not yet officially reported, Appendix B, p. 26).

**II. In holding for the plaintiff on the second cause of action the Court construed Section 16(b) of the Securities and Exchange Act of 1934 (48 Stat. 896, 15 U. S. C. Sec. 78 (b)) contrary to its apparent meaning and intent.**

(a) The transaction did not constitute a "sale" within the intended meaning of that term as used in the statute.

(1) Defendant Mission retained essentially what it had prior to the transaction and received nothing of value in addition thereto;

(2) There could be no sale or disposition of the shares in question while the beneficial interest therein was retained, as held by the Court below;

(3) There was no disposition of the beneficial interest in the shares allegedly sold.

(b) No profits were or could have been "realized."

(c) The transaction did not and could not violate the express purpose of the statute to prevent "short-swing" profits by "insiders."

## POINT I.

**An important question of statutory construction is involved requiring clarification by this Court.**

This Court is judicially aware that a large segment, if not the most important segment, of American business is transacted today by large corporations, the securities of which are listed on national securities exchanges and are subject to the Securities Exchange Act of 1934 (c. 404, §§1-21, 48 Stat. 881, 15 U. S. C. §§78a-78u). Section 16(b) of the Securities Exchange Act is an important provision, concerning the obligations of certain persons in the financial world, including among others, owners of 10% or more of the outstanding equity securities of all such corporations. Corporate reorganizations and intercorporate dealings often make necessary or desirable transactions not unlike those involved in the present case. Frequently time is of the essence in such transactions, and it is not advisable from the corporation's viewpoint to await a six months' aging period, as required by Section 16(b), if applicable, to con-

summate the transactions being contemplated; nor is there any reason of public policy in many of such cases to warrant the postponing of such transactions at the risk of incurring the severe penalty imposed by Section 16(b) of the statute.

The decision of the Court of Appeals in the present case so confuses the law that controlling stockholders or other persons affected by the statute in many instances might hesitate to effect a corporate reorganization otherwise advisable from a business viewpoint. It would appear to be most important to achieve the greatest degree of certainty possible by a clarification by this Court of the interpretation to be given to the statute.

The importance of the statute is attested by the number of times it has come before the courts for construction. (Some of the cases involving Section 16(b) of the Act, 15 U. S. C. §78 p(b) are listed in the footnote.) The greater number of situations where the construction of the statute is important, of course, never reach the courts; desirable or even essential corporate reorganizations may

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[2] *Smolowe* v. *Delendo Corporation*, C. A. 2 Cir. (1943), 136 F. 2d 231, cert. den. 320 U. S. 751.
*Park & Tilford* v. *Schulte*, C. A. 2 Cir. (1947), 160 F. 2d 984, cert. den. 332 U. S. 761.
*Shaw* v. *Dreyfus*, C. A. 2 Cir. (1949), 172 F. 2d 140, cert. den. 337 U. S. 907.
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*Rattner* v. *Lehman*, C. A. 2 Cir. (1952), 193 F. 2d 564.
*Walet* v. *Jefferson Lake Sulphur Co.*, C. A. 5 Cir. (1953), 202 F. 2d 433, cert. den. 346 U. S. 820.
*Pelegrino* v. *Nesbit*, C. A. 9 Cir. (1953), 203 F. 2d 463.
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*Roberts* v. *Eaton*, C. A. 2 Cir. April 5, 1954 (not yet officially reported, printed in Appendix B, p. 26).
*Kogan* v. *Schulte*, D. C. S. D. N. Y. (1945), 61 F. Supp. 604.
*Grossman* v. *Young*, D. C. S. D. N. Y. (1947), 70 F. Supp. 970, 72 F. Supp. 375.

be deferred by reason of the uncertainties concerning the statutory construction, to the detriment of the corporations, their businesses and their stockholders. The opinion of the Court below has failed to contribute to the resolution of such a state of doubt.

This Court has not heretofore seen fit to grant certiorari in a case involving this statute. The cases perhaps did not seem to this Court to present any sharp questions of law for determination. The uncertainty of the Court of Appeals, which has resulted in a distortion of a salutory measure into an automaton of injustice, in the present case, however, calls for this Court to take jurisdiction and to settle the important questions involved for future guidance of those affected by the statute, as well as the courts below.

In the present case the petitioner, a publicly held corporation, announcing that it desired to get control of Tide

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*Pottish* v. *Divak*, D. C. S. D. N. Y. (1947), 71 F. Supp. 737.
*Dottenheim* v. *Emerson Electric Mfg. Co.*, D. C. S. D. N. Y. (1948), 77 F. Supp. 306.
*Truncale* v. *Blumberg*, D. C. S. D. N. Y. (1948), 80 F. Supp. 387, 83 F. Supp. 628, 88 F. Supp. 677.
*Benisch* v. *Cameron*, D. C. S. D. N. Y. (1948), 81 F. Supp. 882.
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*Blau* v. *Hodgkinson*, D. C. S. D. N. Y. (1951), 100 F. Supp. 361.
*Stella* v. *Graham-Paige Motors Corp.*, D. C. S. D. N. Y. (1952), 104 F. Supp. 957.
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*Magida* v. *Continental Can Co.*, D. C. S. D. N. Y. (1952), 12 F. R. D. 400.
*Fistel* v. *Christman*, D. C. W. D. Penn. (1952), 13 F. R. D. 245.

Water Associated Oil Company stock, of which it held approximately 22% prior to either of the transactions involved, and still avoid the penalties of Section 102 of the Internal Revenue Code (26 U. S. C. §102) prohibiting the unlawful accumulation of earnings, adopted, with the consent and approbation of the Securities and Exchange Commission, a plan of organizing a subsidiary corporation, Mission Development Company, and exchanging its holdings of Tide Water for the common stock of such newly organized subsidiary, thus providing shares of the subsidiary for the purposes of paying taxable dividends in kind, and still keeping intact its block of Tide Water shares (*R. 4a-5a;* R. 2a-3a, 29a, 34a, 35a). After the first exchange, petitioner continued to acquire Tide Water shares and subsequently exchanged such Tide Water shares for further shares of its subsidiary on the same basis as the original transaction (*R. 8a-9a*). Each share of Tide Water was exchanged for two shares of its subsidiary in each transaction, so that thereafter petitioner continued to hold the exact beneficial interest in the same number of shares of Tide Water it transferred, continued to control the subsidiary corporation and received nothing of significant value in addition thereto.

The Court of Appeals held that there was no "sale" within the purview of Section 16(b) in the first transaction but that there was such "sale" in the second transaction. The Court of Appeals in its opinion emphasized that its ruling as to the second transaction was not free from doubt, stating (R. 52):

> "• • • there are persuasive features to the argument that Mission parted with nothing but technical title which cannot be deemed such a final disposition of the stock as to constitute a 'sale'."

The Court admitted that it was proceeding "with due caution in venturing on uncharted seas" (R. 53).

Section 3(a)(14) of the Securities Exchange Act of 1934 (15 U. S. C. §78 c(a)(14)) provides: "the terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of." In the present case in neither transaction did petitioner dispose of its beneficial interest in the Tide Water shares transferred to its subsidiary or relinquish control of such shares. The Court of Appeals was careful to point this out, stating with reference to the second transaction (R. 51):

> "At the close of the transaction Mission owned 60% of Development and hence obviously did not relinquish actual control of the Tide Water block of stock. Nor did it alter its beneficial interest in Tide Water, for the second exchange was conducted at the same two shares for one rate and (as is mathematically demonstrable) it received in indirect interest exactly what it gave up in direct interest."

The Court nevertheless held it to be a "sale".

There are only two other cases where the court had to determine whether the particular transaction in issue constituted a "sale" within the meaning of this Statute (*Shaw* v. *Dreyfus,* C. A. 2 Cir., 172 F. 2d 140, cert. denied 337 U. S. 907, and *Truncale* v. *Blumberg,* 80 F. Supp. 387). In *Shaw* v. *Dreyfus,* the majority of the Court of Appeals determined that the term "sale", despite Section 3(a)(14) of the statute above quoted, did not include a gift. Of some significance perhaps is the similarity of the reasoning of Judge Clarke in his dissent in *Shaw* v. *Dreyfus* (172 F. 2d 140), and his reasoning as applied to the second transaction here. The case of *Truncale* v. *Blumberg* (80 F. Supp. 387), likewise involved a gift and arrived at the same conclusion as *Shaw* v. *Dreyfus* (172 F. 2d 140). The cases involving corporate recapitalizations, reorganizations or other similar

transactions where it was necessary to determine what was embraced within the term "purchase" are as follows:

*Roberts* v. *Eaton,* 2d Cir., April 5, 1954 (not yet officially reported, printed in Appendix B, p. 26);

*Blau* v. *Hodgkinson,* D. C. S. D. N. Y. (1951), 100 F. Supp. 361.

In *Roberts* v. *Eaton,* 2d Cir. April 5, 1954 (Appendix B, p. 26), where a reclassification of common stock into preferred and common, in order to facilitate sale thereof, was held not to constitute a "purchase" because approval by stockholders in addition to defendants was necessary, Circuit Judge Clark said (Appendix B, p. 29):

> "• • • in our recent decision in *Blau* v. *Mission Corp.,* 2 Cir., Feb. 24, 1954, we found a 'sale' in an exchange of stock of the issuer for stock of a holding company where substantial quantities of the stock received were publicly held and had an established market, despite the fact that the insider's control of and proportional interest in the issuer remained unchanged.
>
> "On the other side of the coin, in *Blau* v. *Mission Corp., supra,* we held an identical exchange not to be a 'sale' when there was no public ownership and no established market for the stock received."

It would seem from the opinions of the Court of Appeals in the present case and in the case of *Roberts* v. *Eaton,* 2d Cir. April 5, 1954 (Appendix B, p. 30), that there remains considerable doubt and confusion in the minds of the Circuit Court judges as to the validity of their conclusions and the proper interpretation of the statute. Such confusion

and doubts must persist unless this Court takes jurisdiction and settles the question as to whether there can be a "sale" or "disposition" of a security solely by reason of a corporate transaction whereby the transferring corporation continues to retain the exact beneficial interest in the exact shares transferred and control of such shares, and acquires or gains nothing more of value.

## POINT II.

**In holding for the plaintiff on the second cause of action the Court construed Section 16(b) of the Securities and Exchange Act of 1934 (48 Stat. 896, 15 U. S. C. Sec. 78 (b)) contrary to its apparent meaning and intent.**

The target of Section 16(b) of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U. S. C. §78 p(b)), is the prevention of the unfair use of information by a beneficial owner of securities (or a director or officer) obtained through his inside knowledge of future corporate action or business, by making such owner pay back any profit realized in short-swing trading in securities registered on a national securities exchange. There must be a purchase and a corresponding sale resulting in the realization of profit.

**a. The transaction did not constitute a "sale" within the intended meaning of that term as used in the Statute.**

The term "sale" is of ancient usage and generally accepted meaning, but when used in the instant statute it should be limited to the scope of meaning intended by the statute. "Sale" is merely defined in the Act as including a "contract to sell or otherwise dispose of" (15 U. S. C. §78 c (a) (14)).

The pertinent sections of the Act, however, refer throughout to the "beneficial ownership" of equity securities. Record ownership or nominee ownership are not material. Under Section 16(a) (48 Stat. 896, 15 U. S. C. §78 p(a)), "beneficial owners", not record owners, are required to report changes in such ownership, in order to make known potential insider trading. Section 16(b) aims at "preventing the unfair use of information • • • by such *beneficial owner(s)* • • • irrespective of any intention on the part of such *beneficial owner(s)*" to hold the security purchased for more than six months (Securities Exchange Act of 1934, §16 (b), 48 Stat. 896, 15 U. S. C. §78 p(b)). A person must be the beneficial owner of 10% or more of any class of securities before Section 16(b) is applicable. The intention would appear to be to hold beneficial owners liable for short-swing profits realized by such owners from transfers of their beneficial ownership. In the light of the "target" at which the statute is aimed, it is far fetched to hold that a "sale" of a security could occur without the disposition of the only important aspect of ownership, namely, the beneficial interest therein. In short, it would seem clear that a beneficial interest must exist prior to the transfer and, after the transfer cease to exist for a "sale" or "disposition" of a "security" to occur. There must be a complete and final disposition of the security and all beneficial interest therein.

Upon application of these principles to the facts here, it appears there was no "sale" on January 17, 1951 when Tide Water shares were exchanged by Mission for Development shares. Two shares of Development were received for each Tide Water share delivered (*R. 8a*). The same ratio existed on the first exchange (*R. 4a*). At all times each two shares of Development represented one share of

Tide Water held and retained by Development. Mission as the holder of the Development shares retained its beneficial interest and control in the same number of Tide Water shares it had previously purchased, during the six month period in question. As in the first transaction, Tide Water stock was transferred merely to another corporate pocket. It cannot be reasonably maintained that Mission had any more after the transaction in question than it had before the transaction or when it acquired the Tide Water stock.

The situation presented here is precisely the same as in the case of an exchange of shares of stock for voting trust certificates in the same corporation. Both are subject to the vicissitudes of the market.

The Court of Appeals recognized that Mission controlled the Tide Water shares after each exchange and retained its beneficial interest therein (R. 51-52, *Roberts* v. *Eaton*, 2d Cir. April 5, 1954, not yet officially reported, printed in Appendix B hereto, p. 29). It had no difficulty in determining that the first exchange was not a "sale" because control and beneficial ownership were not altered by the transaction. Yet solely because the shares of Development were traded on the stock exchange, the Court determined that the second exchange was a "sale" (*Roberts* v. *Eaton*, 2d Cir. April 5, 1954, Appendix B, p. 29). The only distinction is in the broadness of the market, but that has no bearing on the intended impact of this statute. Potential ease in accomplishment of an uncontemplated and unconsummated sale of Development shares is of no moment.

**b. No profits were or could have been realized.**

The Statute requires that "any profit realized" by the insider "shall inure to and be recoverable by the issuer." (15 U. S. C. §78 p (b)). The profits must be actual and not

fictitious or imaginary. This presents not just a question of measurement of damages, but a fundamental requirement under the statute that there be profit realized through real or potential inside information for liability to arise.

In the instant case, there could have been no realization of profits because, on each exchange of shares of Tide Water for shares of Development, Mission continued to hold the same relative interest in the shares of Tide Water it held before the exchange and nothing more. The subsequent purchase of Tide Water shares in the case of the first transaction and the prior purchase of Tide Water shares in the case of the second did not and could not result in actual or real profits. The shares of Development were subject to the same vicissitudes of the market as the shares of Tide Water exchanged. There were no profits which became actual or were brought into concrete existence.

Realization of profit could, obviously, only have occurred on actual sale by Mission of the shares of Tide Water or the shares of Development which were equivalent and traceable to the Tide Water stock.

The Court below determined that there was "realizable profit" because the Development shares could have been sold and that therefore profit was "realized" under the statute (R. 53-54). This reasoning could be applied to any purchase by a director, officer or 10% beneficial owner, and a finding of liability for profits under §16(b) made, regardless of whether or not there was any subsequent sale. On the "realizable profit" theory of the Court of Appeals, if Mission had not moved the Tide Water shares to another corporate pocket, but had continued to hold them in its own name, it could be argued with equal logic that on any date when Tide Water was selling at a price higher than its cost, any stockholder of Tide Water could

successfully maintain in a suit, such as this, that, since on that date Mission could have sold Tide Water for a profit, therefore, Tide Water is entitled to recover of Mission the difference between the aggregate cost price of all shares purchased below that price, quoted on the date selected, and the market value of such shares on that date. The dangers of the decision of the Court below and the distinction there announced, between the first and second halves of this case, predicated solely on the breadth of the market for Development after the second exchange, become evident. It is to avoid such results that the Act confines itself clearly to situations where profit is "realized" from the disposition of the beneficial interest in listed stock in actual, not constructive, sales.

**c. The transaction did not and could not violate the express purpose of the statute to prevent "short-swing" profits by insiders.**

Coupled with the requirement that profits be "realized" and not merely "realizable" is the influence of potential or real inside information. If, through the statutory fiduciary relationship of the beneficial owner of more than 10% of the stock of a corporation, it is possible to obtain advance knowledge, unknown to the outside trading public, of factors which would enhance or depress the stock exchange market price, and such an owner buys and sells, irrespective of actual knowledge, within any six months period at a profit, such actual gain is recoverable (*Smolowe* v. *Delendo*, C. A. 2d Cir. 136 F. 2d 231). Here, there could be no such benefit to Mission from inside knowledge as to Tide Water or Development in respect of the Development shares received on the exchange. Since Development's assets consisted solely of Tide Water stock, and an insignificant amount of cash (*R. 9a;* R. 50), it would not be

possible for Development stock to be enhanced in price while the price of Tide Water was being depressed or for the Development stock to be worth more, or sell for a higher price, than the Tide Water stock exchanged for it. The court below ignored the factual situation here present in saying that possibly an insider could possess information which when publicly released would depress Tide Water prices, while enhancing those of Development. Development was, in fact, tied completely to Tide Water.

## Conclusion.

It is respectfully submitted that the issues raised by your petitioner involve important and serious questions of federal law relating to the conduct of corporate business, and that they call for the exercise of the supervisory powers of this Court, and that the conflicts in the decisions of the Court of Appeals for the Second Circuit should be eliminated.

Respectfully submitted,

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C. Lansing Hays, Jr.,
Of Counsel.

## Appendix A.

### Securities Exchange Act of 1934, Sections 16 (a)(b) (c. 404, §16 (a)(b), 48 Stat. 896, 15 U. S. C. §78 p (a)(b)).

"§ 78 p. *Directors, officers, and principal stockholders.*

(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been *any change* in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceed-

ing six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

## Appendix B.

UNITED STATES COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

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No. 213—October Term, 1953.

(Argued March 10, 1954 Decided April 5, 1954.)

Docket No. 22973

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CHARLES S. ROBERTS, upon his own behalf and on behalf of all other stockholders of OLD TOWN CORPORATION,
Plaintiff-Appellant,

v.

JOSEPH S. EATON, *et al.*,
Defendants-Appellees,

*and*

OLD TOWN CORPORATION, HARRIETT EATON, *et al.*,
Defendants.

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Before:

CLARK, MEDINA, and HARLAN,
Circuit Judges.

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Appeal from the United States District Court for the Southern District of New York, Henry W. Goddard, Judge.

Plaintiff, Charles S. Roberts, stockholder of (nominal) defendant Old Town Corporation, appeals from a summary judgment denying him recovery under §16(b) of the Securities Exchange Act of 1934, 15 U. S. C. §78p(b), of insider short-swing profits allegedly realized by defendants Joseph

S. Eaton, *et al.*, from transactions in stock of the corporation. Affirmed.

MURRAY C. BERNAYS, New York City (Henry H. Shepard and Ellis J. Freedman, New York City, on the brief), for plaintiff-appellant.

INZER B. WYATT, New York City (Sullivan & Cromwell, Wm. Ward Foshay, and Francis Elwood Barkman, New York City, on the brief), for defendants-appellees.

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CLARK, Circuit Judge:

This appeal presents yet another problem in the considerable series we have had involving the meaning of "purchase" and "sale" as used in §16(b) of the Securities Exchange Act of 1934, 15 U. S. C. §78p(b), holding short-swing profits from dealings by "insiders" in securities of a corporation recoverable for the benefit of the corporation. Our earlier decisions are cited and discussed hereinafter. Before us now is the question whether a district court erred in declining to hold a reclassification of company stock to be a "purchase" within the statutory meaning.

From its incorporation in 1917 until 1947 Old Town Corporation, the nominal defendant, was a family enterprise, 97 per cent owned by defendant Joseph S. Eaton, his wife and children. In 1947 they sold a portion of their stock to the public. In 1952 the family (which for purposes of our discussion may be treated as a unit[1]) owned 45.9 per cent of the outstanding $5 par value common. In that year the family, contemplating Joseph Eaton's retirement, undertook negotiations to sell their remaining stock and discovered that its marketability would be improved by reclassification. Accordingly, in the latter part of 1952 the directors proposed a reclassification of the company's then

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[1] Defendant Philip A. Batchker, the president and a director of Old Town Corporation, acted independently of the Eatons; but his case comes within the same legal principles and requires no separate discussion.

outstanding 320,402 shares of $5 par value common stock into 320,402 shares of common stock of $1 par value and a like number of shares of 40¢ cumulative preferred stock of $7 par value. The proposed change required approval of at least two-thirds in interest of the outstanding common stockholders, and the proxy statement soliciting this approval contained a full discussion of the proposal, together with a frank disclosure of the Eaton's plans to sell out.

At a stockholders' meeting on December 30, 1952, the proposed reclassification was authorized by a vote of 78 per cent of the outstanding shares; and it was thereafter consummated on January 12, 1953. On February 2, 1953, the Eatons concluded negotiations and sold their common stock to one McGraw and his family, simultaneously selling their preferred stock to two life insurance companies and an investment company.

Plaintiff, a stockholder of Old Town and thus authorized by the statute to sue in its behalf, asserts that the Eatons' receipt of reclassified stock was a "purchase" within §16(b).[2] Since this was followed by a sale less than a month later the "profit," so plaintiff contends, inured to the benefit of the company. On defendants' motion for summary judgment the district court held for defendants in a carefully reasoned opinion, stressing that a reclassification of stock, like a stock dividend, did not change any essential rights of ownership in the corporation. We agree in the result reached, but on somewhat different grounds.

In the growing number of §16(b) precedents as to what constitutes a "sale" or "purchase," two lines of cases are

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[2] Section 16(b), 15 U. S. C. §78p(b), provides: "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. • • •"

gradually emerging, though the dividing line is as yet somewhat shadowy. In *Park & Tilford* v. *Schulte,* 2 Cir., 160 F. 2d 984, certiorari denied 332 U. S. 761, we held that voluntary conversion of convertible preferred stock into common was a "purchase." Similarly receipt of stock in a parent corporation in exchange for stock in a subsidiary pursuant to a plan of corporate simplification has been held a "purchase" where the insider had an option to dissent from the plan and receive cash instead. *Blau* v. *Hodgkinson,* D. C. S. D. N. Y., 100 F. Supp. 361. Receipt of warrants by a corporate office pursuant to his contract of employment has also been held a purchase, *Blau* v. *Hodgkinson, supra; Truncale* v. *Blumberg,* D. C. S. D. N. Y., 80 F. Supp. 387; and in our recent decision in *Blau* v. *Mission Corp.,* 2 Cir., Feb. 24, 1954, we found a "sale" in an exchange of stock of the issuer for a stock of a holding company where substantial quantities of the stock received were publicly held and had an established market, despite the fact that the insider's control of and proportional interest in the issuer remained unchanged.

On the other side of the coin, in *Blau* v. *Mission Corp., supra,* we held an identical exchange not to be a "sale" when there was no public ownership and no established market for the stock received. In *Shaw* v. *Dreyfus,* 2 Cir., 172 F. 2d 140, certiorari denied 337 U. S. 907, we held that rights to buy common stock distributed equally to all common stockholders were not "purchased," and indicated that the same reasoning would apply to stock dividends, although acquisition of stock by exercise of the rights came within the section. In the last case we further held that a private gift did not constitute a "sale"; and the same has been held true of a charitable gift, *Truncale* v. *Blumberg, supra,* D. C. S. D. N. Y., 80 F. Supp. 387, though both holdings have been strongly criticized. See Comment, *The Scope* of "Purchase and Sale" Under Section 16(b) of the Exchange Act, 59 Yale L. J. 510; see also Cook & Feldman, *Insider Trading Under the Securities Exchange Act,* 66 Harv. L. Rev. 385, 612; Loss, Securities Regulation 576 (1951).

Thus haltingly we have endeavored to effectuate the statutory mandate to curb insider short-swing speculation. The lines to be drawn become increasingly fine, but the present problem has several characteristics different from those cases where liability has been found. In the latter group the insider had an individual option to acquire the security or not as he saw fit. In those cases the securities acquired were part of a pre-existing class, substantial portions of which were publicly held and which had an independent value in a pre-existing market. In the second half of the *Hodgkinson* and *Mission situations* the securities received were of a different corporation, while in those of *Park & Tilford, Truncale,* and the first half of *Hodgkinson* the acquisition resulted in the insider holding a different proportional interest in the issuer.

The Securities and Exchange Commission, as we are informed and to our regret, see *Blau* v. *Mission Corp., supra,* has declined an invitation to express its views as *amicus curiae.* Defendants seek to draw conclusions as to these views favorable to their case from the Commission's treatment of various reports required by its rules. Thus the proxy statements for both the December 30, 1952, meeting and an annual meeting of stockholders on April 14, 1953, made no reference to possible §16(b) liabilities, yet brought forth no adverse response from the Commission. The same was true of the annual report of the company filed on April 23, 1953, and covering the period in question. Similarly reports by certain of the defendants pursuant to §16(a) which described their acquisition of the new stock as "by reclassification" neither brought forth inquiry nor were included in the Commission's monthly "Official Summary" of purchases and sales by insiders. Defendants support their conclusions by unofficial statements of the Commission's practice as set forth in Cook & Feldman, *supra,* 66 Harv. L. Rev. 385, 388 n. 10, 392-93, 395-97, 407 and n. 85, 410-11. The Commission is not, however, charged with enforcement of §16(b); and we cannot take its performance of its self-assumed duties as conclusive of the issues before us.

On the other hand, plaintiff seeks to divine the Commission's position from its latest promulgation, amending Rule X-16B-6 (February 25, 1954). The amendment, set forth in the margin,[8] creates another in a series of narrow exemptions to our section. It is relevant to our problem only by stretching its negative implications beyond all reasonable bounds. By its terms it does not apply to cases of prior date such as ours, and the widely variant readings given it by counsel reinforce an inclination to deem it not here relevant. It serves merely as an example of the Commission's partial power of legislation in the premises to which we referred in the *Mission* case.

Thus left to our own resources we are not inclined at this juncture to attempt enunciation of a black-letter rubric. Strong arguments have been advanced against each of the enumerated distinctions as not certainly insuring the necessary prophylaxis to the transaction; but each is to some degree persuasive that the transaction is not susceptible to abuses within the ambit of §16(b). Thus the validity of the distinction based upon the option to the individual has been seriously questioned where an insider controls and can work his will through the board of directors. See *Park & Tilford* v. *Schulte, supra,* 2 Cir., 160 F. 2d at page 988. But the objection loses some of its force where, as here, time-consuming ratification by the stockholders was required, and not only the acquisition, but the proposed subsequent sale, was fully disclosed. Nor can it be gainsaid that like treatment of all stockholders will in most cases remove the possibility of abuse.

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[8] "(c) The Commission also hereby exempts, as not comprehended within the purposes of section 16(b) of the Act, the disposition of a security, purchased in a transaction specified in paragraph (a), pursuant to a plan or agreement for merger or consolidation, or reclassification of the issuers' securities, or for the exchange of its securities for the securities of another person which has acquired its assets, where the terms of such plan or agreement are binding upon all stockholders of the issuer except to the extent that dissenting stockholders may be entitled, under statutory provisions or provisions contained in the certificate of incorporation, to receive the appraised or fair value of their holdings."

Similarly to the argument that the Eatons received a security without pre-existing market value plaintiff has directed a forceful reply based upon the value of "when-issued" securities, backing it up with the prices at which the reclassified securities at bar in fact sold on the first day that they were traded. But conceding that a veteran of the market place can venture a shrewd guess as to the future market value of proposed securities of well-known companies, we think this does not settle the question here. In *Mission* we predicated liability on the receipt of seasoned and readily marketable securities, while immunizing the similar receipt of a newly created stock issue. We think the distinction valid, for the intrinsic value of a new issue must relate directly to the underlying property and any variance in market price must depend on market preferences. So here it seems that any change in value due to the split or reclassification of stock comes substantially from the actual or expected tastes and preferences of the public for particular types and forms of securities; and values due to company prospects or plans will be reflected in the ordinary market value of the original stock. The nature of this increment for market taste would seem quite variable, depending upon, *e.g.*, the kind, size, fame, standing, and like factors as to the particular corporation; thus often it would be a most speculative affair, involving a potentially large judgment against corporate officers. But further as to this type of market bonus, the insider has no more knowledge than the rest of the world, and is not benefiting by the fruits of inside speculation. It must be recalled that §16(b) does not strip the insider of all advantage. He may increase or decrease his holdings according to the dictates of his special knowledge. It is only the short-swing transaction which must yield profits to the company alone.

Further reassurance can be found in the fact that after the change in the stock the Eatons continued interested in the same company, with their interests remaining proportionally unchanged—until, of course, their eventual sale of their entire block of stocks. This factor is the one substan-

tially relied on by the district judge in his decision and by defendants in their argument. It is of course an essential for defendants' position; but for reasons stated in the *Mission* case and here we do not think it is alone enough to immunize the transaction from application of the statute. As a matter of fact it seems quite possible that no one of the factors we have enumerated, standing alone, would be sufficient for that result. But in cumulative effect we think they are. The reclassification at bar could not possibly lend itself to the speculation encompassed by §16(b). This being so, it was not a "purchase" and the decision below was correct.

Order affirmed.